

Message Text

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C O N F I D E N T I A L TOKYO 6847

LIMDIS-GREENBACK

PASS FEDERAL RESERVE AND TREASURY

E.O. 11652: GDS

TAGS: EFIN, JA

SUBJECT: JAPAN - POSSIBLE IMPOSITION OF RESERVE REQUIREMENTS ON
BANKS, FOREIGN CURRENCY LIABILITIES

REF: A. TOKYO 6186 B. TOKYO 17160

1. SUMMARY: CITING EXAMPLE OF U.S. AND SOME OTHER ADVANCED NATIONS, JAPANESE AUTHORITIES ARE CONSIDERING IMPOSING RESERVE REQUIREMENTS ON FOREIGN CURRENCY DENOMINATED LIABILITIES OF FOREIGN EXCHANGE BANKS, IN CONJUNCTION WITH FORTHCOMING PACKAGES OF MEASURES LIBERALIZING FOREIGN EXCHANGE CONTROLS. EVEN THOUGH INITIAL RESERVE REQUIREMENT WOULD PROBABLY BE VERY MODEST, SOME ADVERSE REACTION FROM BRANCHES OF U.S. BANKS OPERATING IN JAPAN IS LIKELY, SINCE THEY DEPEND HEAVILY ON FOREIGN CURRENCY BORROWING TO SOURCE THEIR LENDING ACTIVITIES IN JAPAN. ANNOUNCEMENT OF JAPANESE ACTION IN THIS AREA COULD COME AS EARLY AS LATER THIS WEEK, ALTHOUGH TIMING IS NOT YET CLEAR. IF INTERESTED WASHINGTON AGENCIES ANTICIPATE THEY WILL HAVE ANY STRONG REACTION TO ACTION BY JAPANESE AUTHORITIES ALONG FOREGOING LINES,
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EMBASSY WOULD APPRECIATE EARLY GUIDANCE, IF POSSIBLE BEFORE ACTION IS ANNOUNCED. END SUMMARY.

2. REFTEL A INDICATES THAT GOVT OF JAPAN CONTEMPLATES, AT SOME POINT IN TIME, IMPOSING RESERVE REQUIREMENTS ON FOREIGN CURRENCY LIABILITIES OF FOREIGN EXCHANGE BANKS. DISCUSSIONS WITH CONCERNED GOVT OF JAPAN OFFICIALS INDICATE THAT SUCH

A MOVE IS BEING CONSIDERED IN CONJUNCTION WITH FORTHCOMING PACKAGES OF MEASURES OF LIBERALIZATION OF FOREIGN EXCHANGE CONTROL REGULATIONS, FIRST OF WHICH MAY BE ANNOUNCED IN NEXT FEW DAYS. THINKING SEEMS TO BE THAT RESERVE REQUIREMENT WOULD INITIALLY BE INSTITUTED AT VERY LOW LEVEL (LOWER THAN CURRENT 3 PERCENT LEVEL FOR RESERVES AGAINST DOMESTIC DEPOSITS OTHER THAN TIME DEPOSITS) ON OUTSTANDING FOREIGN CURRENCY LIABILITIES OF FOREIGN EXCHANGE BANKS, AND WOULD BE PACKAGED WITH SOME PROBABLY QUITE LIMITED RELAXATION OF CEILINGS ON YEN CONVERSION PRIVILEGE FOR AUTHORIZED FOREIGN EXCHANGE BANKS AND PRHAPS ON IMPACT LOANS. PRESUMABLY THERE WOULD ALSO HAVE TO BE SOME RELAXATION OF CEILINGS ON FOREIGN EXCHANGE POSITION OF AUTHORIZED FOREIGN EXCHANGE BANKS IN ORDER TO MAKE EASING OF RESTRICTION ON YEN CONVER3ION MEANINGFUL.

3. IMPLICATIONS OF MOVE TO IMPOSE RESERVE REQUIREMENTS WILL BE STUDIES CAREFULLY BY FOREIGN EXCHANGE BANKS. AMERICAN (AND OTHER FOREIGN) BRANCHES OPERATING HERE, WHO DEPEND HEAVILY ON FOREIGN CURRENCY BORROWING TO SOURCE THEIR LENDING OPERATIONS CAN BE EXPECTED TO CONSIDER IMPLICATIONS MOST INTENSIVELY. WHILE FOREIGN BRANCHES ARE ALLOWED TO RAISE YEN FUNDS, THERE ARE LIMITS ON THEIR ABILITY TO DO SO (RESTRICTIONS ON BRANCHING IN JAPAN, COMPETITIVE FACTORS, ETC.). EXCEPT FOR BANK OF TOKYO, WHICH ALSO DEPENDS HEAVILY ON FOREIGN SOURCE FUNDS, JAPANESE FOREIGN EXCHANGE BANKS WOULD GENERALLY BE CONSIDERABLY LESS AFFECTED THAN FOREIGN BRNACHES. DESPITE FACT THAT REACTIONS TO RUMORS THAT SUCH REQUIREMENTS WOULD BE IMPOSED DATING BACK TO CONFIDENTIAL

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LAST NOVEMBER (REF B) HAVE BEEN MUTED, SOME ADVERSE REACTION FROM U.S. BRANCHES CAN PROBABLY BE ANTICIPATED.

4. ACTUAL IMPACT ON BANK OPERATIONS OF IMPOSITION OF RESERVE REQUIREMENTS WOULD OF COURSE DEPEND UPON LEVEL OF REQUIREMENT. WHILE PRESENT LEGAL MAXIMUM RESERVE LEVEL AGAINST DOMESTIC LIABILITIES IS 20 PERCENT, MAXIMUM LEGALLY ALLOWABLE AGAINST FOREIGN CURRENCY LIABILITIES IS 100 PERCENT. AS INDICATED ABOVE, JAPANESE AUTHORITIES ARE THINKING OF BEGINNING WITH VERY LOW REQUIREMENT. HOWEVER, IT IS APPARENT THAT LOW REQUIREMENT, WHICH MIGHT ESCAPE WITH RELATIVELY RESTRAINED PROTESTS EVEN FROM BANKS MOST IMPORTANTLY AFFECTED, WOULD BE EQUALLY INEFFECTIVE FOR THE PURPOSE ULTIMATELY INTENDED: TO SUBSTITUTE FOR DIRECT CONTROLS AS A MEANS OF COMBATING SPECULATIVE CAPITAL MOVEMENTS AND INSULATING DOMESTIC MONETARY POLICY. THUS IT SEEMS TO EMBASSY THAT POTENTIAL IMPLICATIONS FOR U.S. BRANCH OPERATIONS -- AND SPECIFICALLY THEIR PROFITABILITY -- WILL INCREASE IN FUTURE.

5. IMPACT OF IMPOSITION OF HIGHER RESERVE REQUIREMENTS IN FUTURE MIGHT WELL BE MITIGATED SOMEWHAT BY MOVING TO IMPOSE ANY HIGHER REQUIREMENT ONLY ON INCREASES IN FOREIGN CURRENCY LIABILITIES (BEYOND SOME BASE LEVEL). IMPOSITION ON SUCH A BASIS WAS PROVIDED FOR IN 1972 LEGISLATIVE REVISIONS. IN ADDITION, IT WOULD BE A MISTAKE TO UNDERESTIMATE THE ABILITY OF THE JAPANESE AUTHORITIES TO TAILOR THEIR ACTIONS TO TAKE INTO ACCOUNT THE IMPACT ON INDIVIDUAL BANKS, INCLUDING FOREIGN BRANCHES. FOR EXAMPLE, PRESENT LIMITS ON YEN CONVERSION PRIVILEGE AND OVERALL FOREIGN EXCHANGE POSITION OF BANKS ARE SET ON A BANK-BY-BANK BASIS, AND JAPANESE AUTHORITIES MIGHT BE ABLE TO MITIGATE IMPACT OF RESERVE REQUIREMENTS ON INDIVIDUAL BANKS ON A CASE-BY-CASE BASIS BY ADJUSTING LENDING CEILINGS, ETC. IT SHOULD BE UNDERSCORED THAT LATTER IS EMBASSY VIEW, NOT STATED VIEW OF JAPANESE AUTHORITIES, WHO HAVE GIVEN NO HINT AS TO DEGREE THEY TAKE INTO

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ACCOUNT COMMERCIAL CONSIDERATIONS IN ADAPTING THEIR CONTROL SYSTEM.

6. IF INTERESTED WASHINGTON AGENCIES ANTICIPATE THEY WILL HAVE ANY STRONG REACTION TO ACTIONS BY JAPANESE AUTHORITIES ALONG LINES SET OUT ABOVE, EMBASSY WOULD APPRECIATE EARLY GUIDANCE, IF POSSIBLE BEFORE MEASURES ARE ANNOUNCED. SOME JAPANESE OFFICIALS HAVE SUGGESTED THAT RESERVE REQUIREMENT WOULD PROBABLY BE IMPOSED IN CONTEXT OF FORTHCOMING MEASURES OF SIMPLIFICATION AND LIBERALIZATION OF FOREIGN EXCHANGE CONTROLS. ONE PACKAGE OF SUCH MEASURES WILL PROBABLY BE ANNOUNCED WITHIN NEXT TEN DAYS AND SECOND PACKAGE LATER THIS MONTH OR EARLY JUNE. OTHER JAPANESE OFFICIALS HAVE, HOWEVER, INDICATED THAT FULL CONSENSUS HAS NOT YET BEEN REACHED ON CONTENT OF PACKAGES, AND POSSIBILITY SHOULD NOT BE EXCLUDED THAT MOVE TO IMPOSE RESERVE REQUIREMENT WILL BE DELAYED, FOR EXAMPLE, UNTIL TIME WHICH WOULD BE MORE PROPITIOUS TO SIGNAL TIGHTENING OF MONETARY POLICY.

7. IN DISCUSSING POSSIBLE IMPLEMENTATION OF RESERVE REQUIREMENTS ON FOREIGN CURRENCY LIABILITIES OF BANKS, JAPANESE OFFICIALS DO NOT FAIL TO NOTE U.S. AND OTHER ADVANCED COUNTRY (E.G. GERMAN) RECOURSE TO SUCH A REQUIREMENT. IN THIS CONNECTION (AND PARTICULARLY IF WE EXPECT TO RAISE OBJECTIONS TO JAPANESE ACTIONS), IT MIGHT BE USEFUL TO SHARE WITH THE JAPANESE AUTHORITIES OUR OWN EXPERIENCE (AND INTENTIONS UNDER PROPOSED FOREIGN BANK ACT) IN APPLYING (OR NOT APPLYING) RESERVE REQUIREMENTS ON FOREIGN LIABILITIES OF BANKS, AND PARTICULARLY OF FOREIGN BRANCHES, ETC. OPERATING IN THE U.S. EMBASSY WOULD IN ANY CASE WELCOME ANY RELEVANT

BACKGROUND INFO ON THIS SCORE WASHINGTON AGENCIES COULD
SUPPLY.

8. CONCERNED JAPANESE OFFICIALS WHO PROVIDED BACKGROUND
ON GOVERNMENT'S THINKING SET FORTH ABOVE SPECIFICALLY ASKED THAT
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U.S. NOT DIVULGE INFORMATION PROVIDED TO COMMERCIAL BANKS.
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Message Attributes

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